Global Conditions Hurting Rural Economy

Although the U.S. economy continues to grow, global economic conditions have adversely affected U.S. mining, manufacturing, and agriculture. The confluence of abundant supplies, the appreciation of the U.S. dollar, and weak demand from Asia and elsewhere have resulted in low agricultural prices. Slow world growth and low farm prices have softened the rural economy.

For the last 4 years of the current economic expansion, nonmetro employment has been growing more slowly than metro employment. Employment growth in nonmetro areas was sluggish in 1998. The Current Population Survey and Local Area Unemployment Statistics data as of the third quarter 1998 both show stagnant nonmetro employment growth. While the United States is expected to avoid recession in 1999, weaknesses in agriculture, mining, and manufacturing are likely to induce continued softness in nonmetro area employment.

Asia Crisis Has Spread

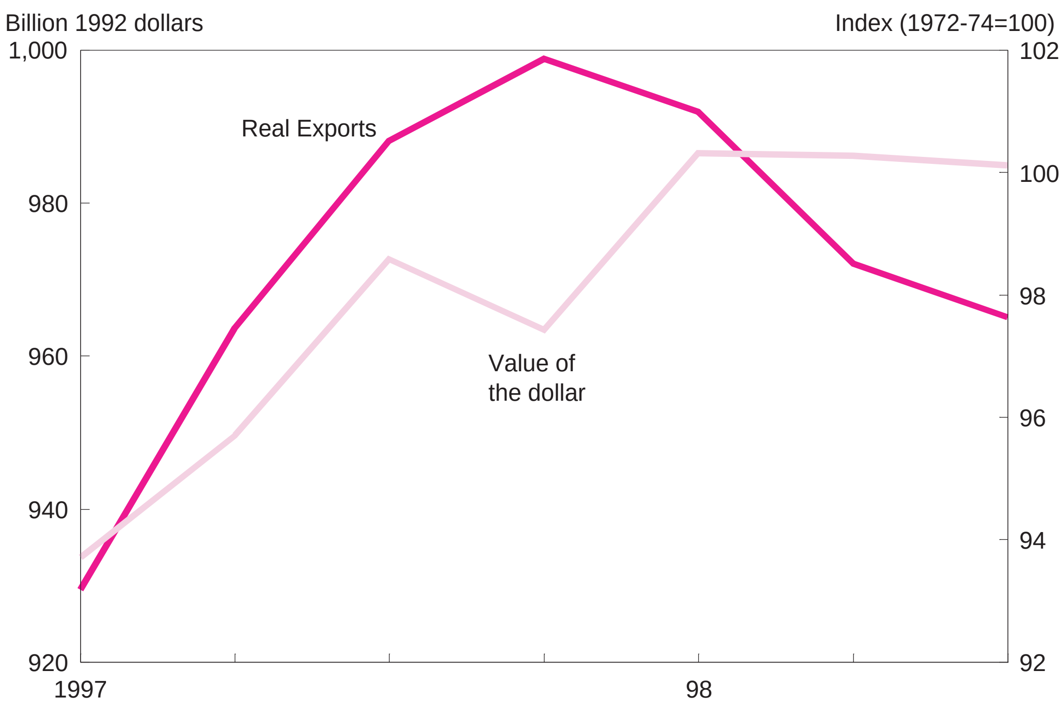
What began solely as a run on the Thai stock and currency markets turned into an Asian financial crisis severe enough to pull Japan into recession. The spillover of this crisis lowered equity prices around the world. The search for safe investments bid up the price of U.S. bonds and the dollar. The Treasury bond yield, which is inversely related to bond price, fell 1 percentage point to the lowest level since 30-year bonds were first issued in 1977. The world growth slowdown, a strong dollar, and jittery financial markets provided an unfavorable environment for U.S. goods exports (fig. 1). In particular, exports and prices in mining and manufacturing were hit hard.

Three factors contributed to low U.S. agricultural prices. Large crop harvests worldwide were the primary factor, and would have reduced world crop prices even without the global economic crisis. On the demand side, domestic prices fell further as the strong U.S. dollar converted the reduced world prices into lower U.S. prices. In addition, weaker

Figure 1

Real exports and Federal Reserve Board trade-weighted value of U.S. dollar, 1997-98

Real exports declined while the dollar stayed strong



Source: National Income and Product Accounts, Bureau of Economic Analysis, and Federal Reserve Board of Governors.

world growth and the stronger dollar cut demand for U.S. agricultural exports. This softened demand translated into more downward pressure on U.S. agricultural prices.

The concerns about the spillover of the world financial crisis on the U.S. economy became serious enough that in August the Federal Reserve Board (Fed) changed its monetary policy by cutting short-term interest rates. In September, October, and again in November, the Fed cut the Federal Funds rate, the rate banks charge each other to cover reserve requirements. In response to the lower Federal Funds rate and declining long-term Treasury bond yields, banks reduced lending rates.

The effects on U.S. business were most apparent in the internationally exposed sectors. The real trade deficit widened $120 billion between the third quarter of 1997 and the third quarter of 1998. The decline in manufacturing output throughout the first three quarters of 1998 was due to both import substitution and declining exports of manufactured goods, as well as the General Motors (GM) strike. Mining, including crude oil extraction, also faced weak export demand resulting in low prices. Although crude oil prices mildly recovered in the summer, they declined sharply in the fall.

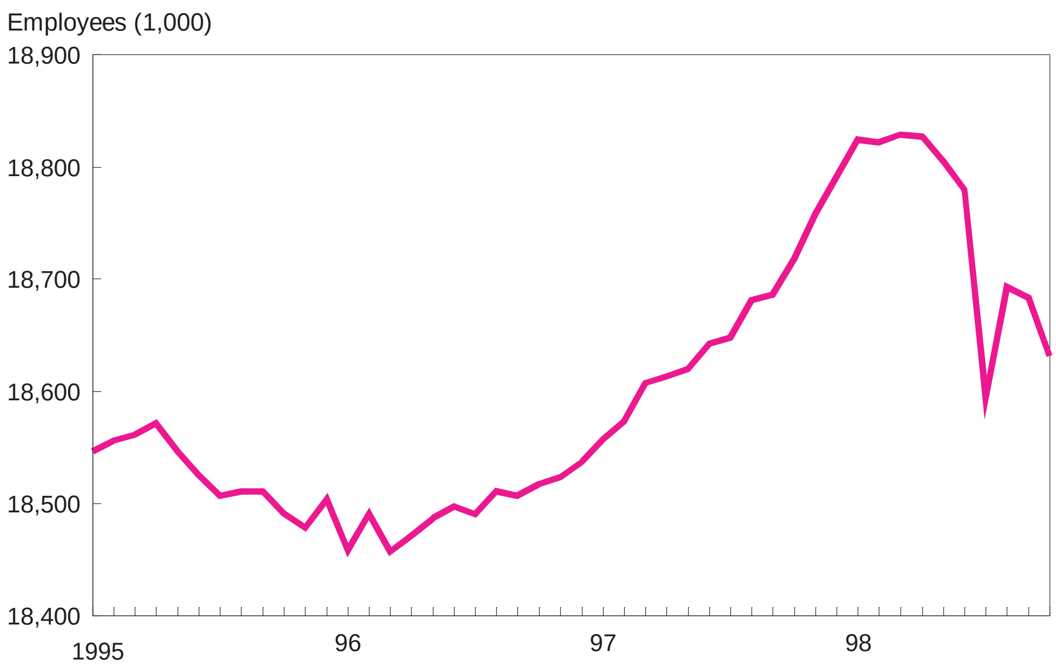
U.S. durable goods output rose moderately for the first three quarters of 1998 compared with 1997, despite the GM strike. Nondurable goods output grew modestly in the same period as did real wages in manufacturing. Wall Street estimates of manufacturing profits as a whole fell in the third quarter of 1998, reflecting declining profit margins due largely to lower export prices and higher wages. In the third quarter, weak demand for manufactured goods led to a modest decline in manufacturing employment, which would have been larger had many workers not been returning at the end of the GM strike (fig. 2). However, employment continued to expand in other sectors of the economy.

Apart from a moderate increase in credit standards for large businesses in the latter half of 1998 and a modest stock market correction triggered by the contagion of the bad news

Figure 2

U.S. manufacturing employment, 1995-98

Weak demand led to declining manufacturing employment in the third quarter of 1998, despite the bounce-back from the GM strike



Note: Data are seasonally adjusted.
Source: Bureau of Labor Statistics.

from Russia, Asia, and Latin America, domestic demand continued to grow. Consumer demand in 1998 was strong as rising real wages spurred higher personal income. Consumer credit was readily available, and saving rates dropped. In addition, low long-term interest rates, resulting from lower Treasury bond yields, allowed many consumers to refinance mortgages. This increasing cash flow spurred higher consumer spending. Lower stock prices were only a modest drag on consumer spending. New housing starts grew due to high personal income and low interest rates. Strong profits of nonfinancial businesses in the first half boosted business plant and equipment spending. Low inflation, due to falling raw material and energy prices, further boosted growth. Low input prices contributed to strong labor productivity growth, especially in the first half of 1998. For the year, inflation was estimated at below 1.5 percent, and GDP grew an estimated 3.4 percent, despite a rising trade deficit.

Prospects for 1999 Are for a Moderating U.S. Economy

Consumer spending is expected to be strong in 1999, due to continued rising real wages. Investment spending growth will likely moderate from the fast pace of early 1998. Low interest rates, available credit, and good business prospects will fuel plant and equipment spending. The trade deficit will be larger, due to the continued strength of the dollar and sluggish world growth. Despite the world growth slowdown, Canadian and European growth are expected to be moderate. Inflation is expected to be only slightly higher, about 2 percent, as commodity prices stabilize and real wage growth slows. Employment growth will slow as productivity growth rises, resulting in strong GDP growth.

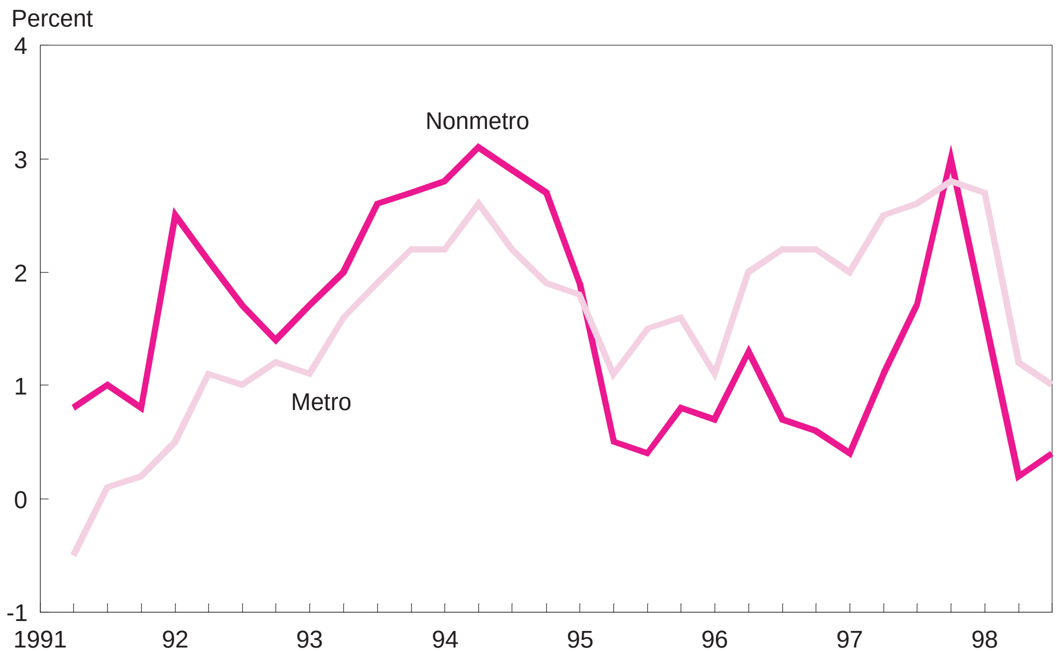
Asian Crisis Hurts Nonmetro Areas

This economic expansion has been marked by three phases for nonmetro areas. First, during the recovery years of 1991-94, rural economies showed strong economic performance and outperformed metro areas by several measures. Second, since 1995, however, nonmetro growth slowed while metro growth picked up (fig. 3). This slowdown coincided with a slower rate of net inmigration of population to nonmetro areas. The population

Figure 3

Nonmetro and metro employment growth, 1991-98

Nonmetro employment growth has fallen behind metro growth since 1995



Source: Calculated by ERS using Local Area Unemployment Statistics from the Bureau of Labor Statistics.

movement to nonmetro areas slowed as job creation slowed. Third, in 1998, the crisis in developing economies and abundant world stocks of agricultural commodities affected three U.S. industries: agriculture, mining, and manufacturing. U.S. exports have sharply dropped in these industries. These industries provided 26 percent of nonmetro jobs and only 14 percent of metro jobs in 1996. (See appendix table 1—Nonfarm jobs by industry and BEA region, 1996.)

The slowdown in world economic growth affected the nonmetro labor market. In the third quarter of 1998, the nonmetro unemployment rate increased to 4.9 percent while the metro rate stayed essentially the same throughout the first three quarters, averaging 4.5 percent. This divergence of the two unemployment rates is important in that the two rates have been about the same for the last several years. The two employment data sources showed negligible movement in the number of nonmetro jobs over the first three quarters of 1998.

Another factor contributing to the softness in the nonmetro employment situation is the longrun trend toward fewer mining and Federal Government jobs. Mining has been shrinking in employment since 1981 due to productivity increases and increased low-cost energy imports. Federal Government employment has shrunk due to downsizing and military base closings. Although these two industries together provide only 1.1 million nonmetro jobs out of a total 25.4 million in 1996, this employment tends to be highly paid and geographically concentrated and so is important in rural areas.

Nonmetro Prospects

Most macroeconomic analysts expect continued strong U.S. GDP growth in 1999. The East Asian recovery is moving faster than had been expected. Still, the U.S. trade deficit is expected to widen. Employment growth in nonmetro areas is likely to be weak over the next year due to an increasing trade deficit. *[Data as of 11/20/98. David Torgerson, 202-694-5443, dtorg@econ.ag.gov, and Karen S. Hamrick, 202-694-5426, khamrick@econ.ag.gov]*